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No. 426

In the Supreme Court of the United States

OCTOBER TERM, 1931

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CHARLES P. LEININGER

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE PETITIONER

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 17) is reported in 19 B. T. A. 621. The opinion of the Circuit Court of Appeals for the Sixth Circuit (R. 25) is reported in 51 F. (2d) 7.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 30, 1931 (R. 24). The petition for certiorari was filed September 30, 1931, and granted November 2, 1931. Jurisdiction is con-

ferred upon this Court by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether under the income-tax provisions of the Revenue Acts of 1918 and 1921, respondent may be taxed on such income, distributed to him as a member of a partnership, as he was under a duty to pay to his wife pursuant to an agreement between them by which he made her an equal partner with him in his interest in the partnership.

STATUTES AND REGULATIONS INVOLVED

These appear in Appendix A, pp. 29–31, *infra*.

STATEMENT

On petitions for redetermination of deficiencies in income taxes of respondent for the years 1920, 1921, 1922, and 1923, the Board of Tax Appeals made findings of fact (R. 16–17) of which the following is a summary:

Respondent has owned a one-half interest in the Eagle Laundry Company, a partnership, since 1898. In 1920, he and his wife confirmed, in writing, an existing oral agreement which acknowledged her as an equal partner with him in his interest in the partnership, entitled to share equally in the profits and obligated to bear equally the losses. The contract was to be effective from January 1, 1920. The fact of the transfer was communi-

cated to the representative of the owners of the other one-half interest in the Company, but it does not appear whether or not the representative or his principals acquiesced in the arrangement.

Respondent's wife took no part in the management of the business of the Company and made no contribution to its capital. It does not appear that she ever acquired or attempted to exercise any authority to act as its agent. Respondent's one-half interest continued to stand in his name on the Company's books, and its income tax returns for the years 1921, 1922, and 1923, sworn to by respondent, stated that he and M. T. Monaghan were the members of the partnership and that one-half of the income was distributable to each. (R. 16, 17, 18.)

Checks representing respondent's one-half interest in the profits of the partnership were drawn to his order. He deposited them in a joint bank account, maintained by him and his wife before and during the period in question, on which either could draw unrestrictedly. The wife also had a personal account during the period in question, in which she deposited earnings from her personal investments. Respondent and his wife never had a formal accounting. The contract between respondent and his wife was never filed with any public official or in any place of public record. (R. 17.)

The petitions and answers filed with the Board disclose the following facts:

In 1920, respondent returned for income tax purposes two-thirds of the profits he received on his one-half interest in the partnership, and his wife returned the rest. In 1921, 1922, and 1923 each returned one-half of the sums which respondent received on his one-half interest in the partnership. (R. 6, 9, 15, 17.) The Commissioner of Internal Revenue determined deficiencies for the years 1920 to 1923 on the ground that all the profits payable on respondent's one-half interest in the partnership were taxable to him. (R. 3, 6, 7.)

These determinations were approved by the Board of Tax Appeals, which held, in effect, that the wife was not a partner in the Company, and that if she were a sub-partner or in partnership with respondent alone, the income received by respondent on his one-half interest in the Company was income to him, taxable as such before its division with her. (R. 17–18.)

Respondent filed a petition for review in the Circuit Court of Appeals for the Sixth Circuit, which reversed the order of the Board (R. 24), holding that, regardless of whether the wife became a partner in the Company, half the profits received by respondent were taxable to her as equitable owner of half the sums paid him by the Company (R. 25–26).

The evidence is not reported in the record, and the findings of the Board are not challenged.

SPECIFICATION OF ERROR TO BE URGED

The Circuit Court of Appeals erred:

In holding that the agreement between respondent and his wife entitled him to deduct from the taxable income received by him from the partnership the payments due her under their agreement.

SUMMARY OF ARGUMENT

I

The Revenue Acts of 1918 and 1921 levied taxes upon the "net income of every individual" and provided that gross income should include "gains or profits and income derived from any source whatever." They also provided that individuals carrying on business in partnership should be liable for income tax only in their individual capacity and that there should "be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year."

It seems clear that if Congress had wished it could have taxed partnerships as entities. Although it treated partnership income in accordance with the doctrine of the common law, nothing in the statutes indicates that it intended to permit a further reduction of the amount of tax by partial assignments of what a partner might withdraw. We submit that no agreement or assignment in respect of the income or the partnership can relieve a partner from a tax on any of his share of the partner-

ship income unless what he has done has resulted in constituting the assignee a member of the partnership.

Practically all the decisions of the lower Federal courts are in accord with this contention.

The taxation of partnership income to the partners without regard to whether or not they are its ultimate beneficial owners is not anomolous. There are three analagous situations where one who is not the ultimate beneficial owner of income is taxed upon it—(1) where income produced by the personal services of the taxpayer is assigned, as in *Lucas* v. *Earl,* 281 U. S. 111; (2) where income earned by property or capital is assigned without assignment of the property or capital producing the income, as in a number of cases decided by several of the Circuit Courts of Appeals; and (3) where control over the source of the income is retained, although title to the producing *corpus* as well as to the income is assigned, as in *Corliss* v. *Bowers,* 281 U. S. 376.

II

Respondent's wife did not become a member of the partnership. It does not appear that the agreement purported to constitute her a member of the partnership. In order to establish that she had become a partner, it was necessary to prove that the other partners consented to such an arrangement. There is no finding that such consent existed, and all fair inferences are to the contrary. Moreover, she did not possess other powers which

ordinarily or necessarily inhere in a partner. The mere right to share in the profits of a partnership does not make one a partner. The wife's agreement to bear a share of her husband's partnership losses does not alter the situation, since her promise in that respect ran to him alone and not to the firm or the other partner.

If this Court should hold that taxability of income always follows the ownership of the income-producing *corpus*, the respondent still must fail, since the ownership of the physical and intangible assets of a partnership follows the status of a partner. Moreover, in Ohio, as elsewhere, a partner does not own a direct interest in the partnership property, but has only a right to his share of the profits, and, upon dissolution, to his share, if any, of the assets of the firm remaining after the payment of debts and adjustment of the rights of the partners *inter sese*. If a partner attempts to convey an interest in the assets of the firm, the partnership is dissolved forthwith. Here there was no such dissolution, and it does not appear that the wife asserted any claim to ownership of partnership assets. It seems clear that all the agreement was intended to accomplish was to give her the right to one-half of the profits paid respondent and possibly the right to one-half of the assets, if any, distributed to him upon the dissolution of the firm. These were merely rights against the respondent on the contract with him, and not, like his rights, against the partnership *in rem*.

ARGUMENT

I

INCOME DISTRIBUTABLE TO A MEMBER OF A PARTNERSHIP IS TAXABLE TO HIM WHETHER OR NOT HE IS THE BENEFICIAL OWNER OF THE INCOME

Sections 210 and 211 of the Revenue Acts of 1918 and 1921 (pp. 29, 30, *infra*) levy taxes upon "the net income of every individual," and Section 213 provides that gross income shall include "gains or profits and income derived from any source whatever." We submit that this language operates to impose the tax upon the entire amount of partnership income distributed to a partner even though he has agreed to pay it to another. See *Lucas* v. *Earl*, 281 U. S. 111. But any doubt left by these sections as to the intention thus to tax partnership income should be removed by Section 218 (a) of each of these Acts (pp. 29–30, *infra*), which provides:

> That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year * * *.

It seems clear that if Congress had wished, it could have treated partnerships as entities for income tax purposes, see *Burk-Waggoner Assn.* v. *Hopkins*, 269 U. S. 110, as it had for the excess profits tax. Section 201, Act of October 3, 1917, 40

Stat. 303, *infra* p. 30. Congress has, however, chosen to apply the common law rule that a partnership is to be regarded as an association of individuals rather than as an entity, and has provided for the taxation of partnership income to the partners to whom it is distributable. But, as the Circuit Court of Appeals for the Second Circuit said in *Harris* v. *Commissioner*, 39 F. (2d) 546, 547:

> Section 218 (a) did indeed continue to treat the firm income in accordance with the doctrine of the common law, in so far as it did not tax it as a whole; it allowed each partner to return only his own share, with the result that the sum of the individual taxes was less than if the firm had been taxed as an entity. It seems to us, however, that to permit a further reduction by partial assignments of so much as a partner may withdraw during the year, disregards the plan of partnership taxation, which is apparent in the section. In the first place the tax would in that case depend upon the accident of how much the partner chooses to withdraw in a given year, so offering opportunity for manipulation. In the second, the tax is imposed anyway upon the profits before distribution, and all profits must be so declared before they can be withdrawn, though in practice declaration and withdrawal may be simultaneous.

We submit that the effect of the provisions of the statute quoted above is to tax the income of a partnership to the persons who are partners at the time when the income is earned, and that no agreement [illegible] an outsider in respect of the income or

the partnership can alter or shift the obligation to pay the tax unless he becomes a member of the partnership. The agreement in the instant case did not have this result. (See pp. 23–26, *infra*.)

In the present case, respondent's wife took no part in the management of the business, and we may assume that the respondent was actively engaged in its management. Probably the formulation of the business policies of the company devolved largely upon him. If so, he determined to a considerable extent the amount of net income which his wife would receive, since the creation of gross income lay partly within his power, and still more its expenditure and thus the determination of the deductions to be made from gross income. For example, her right to receive any specific amount of net income could exist only after he had determined whether to spend the gross income in the purchase of a capital asset, or in repairs of existing property, or in payments to employees for services or bonuses, or to retain it as a reserve for the future. Apparently, under the theory advanced by the court below, the wife could not be taxed on income not distributed to her husband. Since such income is expressly taxed to the partners by Section 218 (a), respondent would be subject to the entire tax due on it. If this be the rule, then profits earned by the partnership in one year and not distributed until the next would all be taxed to the husband under Section 218 (a), but if distributed in the year when earned would be taxed one-

half to the husband and one-half to the wife under the decision of the court below.

These considerations illustrate the inconsistencies and difficulties which would be encountered in applying the test adopted by the court below, i. e., whether the agreement between the respondent and his wife was effective, *as between them,* to make her the equitable and ultimate beneficial owner of one-half of the income distributed to the respondent. We submit that no such test as this is indicated by the statute, and that the application of such a test would open the door to wholesale evasion of the scheme of partnership taxation created by Congress.

Practically all the decisions of the lower Federal tribunals are in accord with our contention.

In *Mitchel* v. *Bowers,* 15 F. (2d) 287 (C. C. A. 2nd), the plaintiff sued to recover income taxes paid on his share of the profits of a partnership of which he was a member. He asserted that he should have been taxed on only half of his share because of an agreement with his wife by which she was "entitled to one-half of the profits which shall come to" the plaintiff "from said firm" and was "liable to pay" him "one-half of the losses which he may sustain by reason of his partnership." The court assumed that the agreement did not make the wife a member of the partnership, and affirmed a judgment for the defendant Collector. This Court denied certiorari. 273 U. S. 759.

The court below in the present case (R. 25) and respondent in his brief in opposition to the petition for certiorari (p. 5) seek to distinguish the *Mitchel* case on the ground that the court there rested its decision on a provision of the contract between the husband and wife which permitted either party to terminate it at any time. The Circuit Court of Appeals for the Second Circuit has indicated in a subsequent case that the broader ground of decision stated in the quotation *supra* p. 9, was one of *two* grounds for the decision in the *Mitchel* case. See *Harris* v. *Commissioner, supra,* 39 F. (2d) 546, 547.

In *Larsen* v. *Burnet,* 50 F. (2d) 308 (Ct. App. D. C.), the taxpayer became a member of a partnership. His wife had a half interest in the funds he contributed to the partnership, and they understood that she would remain the owner of such interest. He and the wife each returned for income tax purposes half of his income from the partnership. The Commissioner took the view that all the income should have been returned by him and assessed the tax on that basis. The Board of Tax Appeals upheld the Commissioner. In the Court of Appeals the taxpayer made the same contention as was made by respondent in this case, that he became a trustee for his wife as to one-half of his investment in the partnership and also one-half of the profits accruing from the investment. In affirming the order of the Board, the Court of Appeals said (p. 309):

> We think this argument is untenable. * * * It is * * * true that appellant was accountable to his wife under the circumstances for the investment which he was managing for her. Nevertheless appellant's wife was not an actual partner in the firm, for the copartnership consisted of appellant and Forcia alone; and the applicable statute requires that the distributive share of each partner, of the net income of a partnership shall be included in the individual return of the partner for the taxable year.

In *Hill* v. *Commissioner*, 38 F. (2d) 165 (C. C. A. 1st), the members of a partnership agreed that if any of the partners died, the surviving partners would pay the estate of the deceased partner for three years following his death "sums equal to the full amount of his net profits" for each of those years. One of the partners, Soule, died. The firm was reorganized, and provision was made for the payment of the sums due Soule's estate from the profits of the new firm. The Commissioner assessed the sums paid to the estate against the surviving partners as income distributable to them. The Board of Tax Appeals and the Circuit Court of Appeals upheld the assessment. This Court denied certiorari. 281 U. S. 761.

The *Hill* case was followed in *Pope* v. *Commissioner*, 39 F. (2d) 420, 424 (C. C. A. 1st). See also *Cohan* v. *Commissioner*, 39 F. (2d) 540 (C. C. A. 2d); *Benedict* v. *Collector*, 38 F. (2d) 309, 313–314

(E. D. N. Y.). Compare *Hellman* v. *United States*, 70 Ct. Cls. 498, 512–513.

The Board of Tax Appeals has taken the same view of the statute. *Appeal of Mitchel*, 1 B. T. A. 143, 148; *Appeal of Kneeland*, 1 B. T. A. 150; *Levering* v. *Commissioner*, 5 B. T. A. 616; *Knapp* v. *Commissioner*, 5 B. T. A. 762, 766; *Hill* v. *Commissioner*, 10 B. T. A. 399; *King* v. *Commissioner*, 10 B. T. A. 698, 703; *Cohan* v. *Commissioner*, 11 B. T. A. 743, 757–758; *Harris* v. *Commissioner*, 11 B. T. A. 871, 875; *Colbert* v. *Commissioner*, 12 B. T. A. 565, 567–568; *Larsen* v. *Commissioner*, 14 B. T. A. 160; *Hill* v. *Commissioner*, 14 B. T. A. 572; *Staebler* v. *Commissioner*, 17 B. T. A. 1086; *Luce* v. *Commissioner*, 18 B. T. A. 923, 926–927; *Leininger* v. *Commissioner*, 19 B. T. A. 621 (the present case); *Heinickle* v. *Commissioner*, 20 B. T. A. 155, 160–161; *Houston Bros.* v. *Commissioner*, 22 B. T. A. 51, 63–64; *Battleson* v. *Commissioner*, 22 B. T. A. 455.

The court below cited *Commissioner* v. *Barnes' Estate*, 30 F. (2d) 289 (C. C. A. 3rd), as supporting its holding. The *Barnes* case has been cited twice by other courts. The Circuit Court of Appeals for the Second Circuit said, in *Harris* v. *Commissioner*, *supra*, 39 F. (2d) 546, 547:

> Just what were the grounds of the decision of the Third Circuit in *Commissioner of Internal Revenue* v. *Barnes*, 30 F. (2d) 289, the short opinion does not very clearly

disclose. So far as we can gather, it did not involve the point now under discussion.

The Court of Appeals of the District of Columbia said, in *Larsen* v. *Commissioner, supra,* 50 F. (2d) 308, 309:

> This decision is not touched upon by *Commissioner of Internal Revenue* v. *Barnes' Estate,* 30 F. (2d) 289, for in the latter case the wife was entitled directly to receive a share in the profits of a partnership by virtue of an assignment executed in accordance with the Uniform Partnership Act of Pennsylvania (Act of March 26, 1916), pt. 5, Sec. 27 (1), 59 P. S., Sec. 74. See *Barnes' Estate,* 7 B. T. A. 924.

See also, as to the effect of the Pennsylvania statutes, *Parshall* v. *Commissioner,* 7 B. T. A. 318. In *Heinickle* v. *Commissioner,* 20 B. T. A. 155, 161, the Board of Tax Appeals said:

> * * * in our opinion, the decision in that case [*Commissioner* v. *Barnes*] is contrary to the weight of authority.

Several decisions of the Board of Tax Appeals are relied upon by respondent. *Wing* v. *Commissioner,* 17 B. T. A. 1028, cited in his brief in opposition (p. 7), is clearly distinguishable from the present case. There the wife contributed to the capital of the partnership; took charge of the firm's bookkeeping; was a signatory of the partnership agreement, in which she was named as a partner; and was directly paid her share in the partnership

earnings. Partnerships in fact also existed in *Hinshaw* v. *Commissioner,* 16 B. T. A. 1236, and *Dickinson* v. *Commissioner,* 23 B. T. A. 1211, cited in respondent's brief in opposition at page 8. The question in the *Wing* and *Dickinson* cases was what effect should be given to the law of Michigan forbidding partnerships between husband and wife. See 23 B. T. A. 1211, 1217-1218. *Parshall* v. *Commissioner,* 7 B. T. A. 318, dealt with a Pennsylvania statute. See *supra,* p. 15. In *Kier* v. *Commissioner,* 15 B. T. A. 1114, the wives supplied the capital, and were signatories of an agreement by which, the Board found, it was the intention of all the parties to make the wives partners. Thus none of these cases are in point.

The other decisions of the Board cited in the brief in opposition are probably distinguishable on their facts. If not, they are contrary to the overwhelming weight of authority, including some of the decisions of the Board to which we have referred.

The taxation of partnership income to the partners without regard to whether or not they are its ultimate beneficial owners is not anomalous. There are three analogous situations where one who is not the ultimate beneficial owner of income is taxed upon it. Those situations are as follows: (1) Where income produced by the personal services of the taxpayer is assigned; (2) where income earned by property or capital is assigned without assignment of the property or capital producing

the income; and (3) where control over the source of the income is retained although title to the producing *corpus* as well as to the income is assigned. We shall discuss these separately.

(1) In *Lucas* v. *Earl*, 281 U. S. 111, the taxpayer and his wife agreed—

> that any property either of us now has or may hereafter acquire * * * in any way, either by earnings * * * or otherwise * * * is declared to be received * * * and owned by us as joint tenants * * *.

The question was whether the whole of the salary and attorney's fees earned by the taxpayer should be taxed to him, or only half. In holding the former, this Court said (pp. 114–115):

> A very forcible argument is presented to the effect that the statute seeks to tax only income beneficially received, and that taking the question more technically the salary and fees became the joint property of Earl and his wife on the very first instant on which they were received. We well might hesitate upon the latter proposition, because however the matter might stand between husband and wife he was the only party to the contracts by which the salary and fees were earned, and it is somewhat hard to say that the last step in the performance of those contracts could be taken by anyone but himself alone. But this case is not to be decided by attenuated subtleties. It turns on the import and reasonable construction of the tax-

> ing act. There is no doubt that the statute could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements and contracts however skilfully devised to prevent the salary when paid from vesting even for a second in the man who earned it. That seems to us the import of the statute before us * * *.[1]

Other cases falling in this group are: *Van Brunt* v. *Commissioner,* 11 B. T. A. 406; *Luce* v. *Commissioner,* 18 B. T. A. 923, 926-927; *Stack* v. *Commissioner,* 22 B. T. A. 707, 712; *Daugherty* v. *Commissioner,* No. 41905, decided by the Board of Tax Appeals on October 29, 1931, and reported in Prentice-Hall Federal Tax Service (1931), p. 2300.131; see also *Belcher* v. *Lucas,* 39 F. (2d) 74 (C. C. A. 9th). Compare *Commissioner* v. *Field,* 42 F. (2d) 820, 822 (C. C. A. 2d).

The *Earl* case and the other personal service cases cited are analogous to the present case if, as we assume, respondent was an active partner in the Eagle Laundry Company, devoting his personal services to the management of its business. The record does not reveal to what extent, if any, the payments on his half interest in the company were payments for the use of capital. The payments may have been made exclusively in return for respondent's per-

[1] The court below thought that the *Earl* case had been qualified by this Court in *Poe* v. *Seaborn,* 282 U. S. 101 (which dealt with community property), but we do not understand that the latter case had that effect.

sonal services. Respondent's wife took no part in the management of the business. (R. 17.) Therefore, even if we assume that she became the owner of one-fourth of the physical assets of the partnership by virtue of the agreement with her husband,[2] the Commissioner is entitled to prevail because of respondent's failure to establish the extent to which the income paid on his half interest in the company represented payments for the use of capital. *Larsen* v. *Commissioner*, 14 B. T. A. 160, 165. The burden rested on respondent to establish every fact necessary to his case. *Phillips, Collector* v. *Dime Trust & Safe Deposit Co.*, 284 U. S. —, No. 18 October Term, 1931, decided November 23, 1931.

(2) In *Bing* v. *Bowers*, 22 F. (2d) 450 (S. D. N. Y.), the taxpayer had assigned to his mother, by deed, an annuity "out of my share of the rents, income, and profits from my interest in all the property, real and personal" in the hands of a named company. The annuity was made a charge on his interest in the property, and the company was directed to pay the annuity to the mother. The court held that the deed did not carry an interest in the properties mentioned, but only in the net income or profits from them, and that therefore the income was taxable to the assignor. It said (p. 454):

> To permit the assignor of future income from his own property to escape taxation thereon by a gift grant in advance of the re-

[2] The Government contends that she did not become such an owner. *Infra*, p. 26–28.

> ceipt by him of such income would by indirection enlarge the limited class of deductions established by statute. As long as he remains the owner of the property, the income therefrom should be taxable to him as fully, when he grants it as a gift in advance of its receipt, as it clearly is despite a gift thereof immediately after its receipt.

The decision of the District Court was affirmed by the Circuit Court of Appeals for the Second Circuit, on the opinion of the trial judge. 26 F. (2d) 1017.

Other cases in this group are *Rosenwald* v. *Commissioner,* 33 F. (2d) 423 (C. C. A. 7th), certiorari denied, 280 U. S. 599; *Leydig* v. *Commissioner,* 15 B. T. A. 124, affirmed, 43 F. (2d) 494 (C. C. A. 10th); *Porter* v. *United States,* No. L–69, decided by the Court of Claims on November 2, 1931, and reported in Prentice-Hall Federal Tax Service (1931), p. 2300.150; *Bishop* v. *Commissioner,* No. 4517, decided by the Circuit Court of Appeals for the Seventh Circuit on December 9, 1931, reported in Prentice-Hall Federal Tax Service (1932), p. 388.

The cases in this group are analogous to the present case because, even if we assume that respondent's share of the partnership profits was paid to him wholly or partly for the use of capital,[8] nevertheless the record does not support the contention

[8] As we have indicated, *supra*, pp. 18–19, respondent has failed to show the extent, if any, to which the payments were for the use of capital.

that the agreement between respondent and his wife conferred upon her any interest in the partnership assets. See Point II, *infra*, pp. 26–28.

The following cases, where it was held that the income was taxable to the assignee and not to the assignor, may be distinguished on the ground that in them it appeared that the assignor had divested himself not only of the beneficial interest in the income but also of the ownership of the property or capital producing it: *Hall* v. *Burnet*, Nos. 5173, 5174, decided November 16, 1931, by the Court of Appeals of the District of Columbia, reported in Prentice-Hall Federal Tax Service (1931), p. 2300. 179; *Copland* v. *Commissioner*, 41 F. (2d) 501, 504 (C. C. A. 7th, distinguishing *Bing* v. *Bowers* and *Rosenwald v. Commissioner, supra*); *Commissioner* v. *Field* 42 F. (2d) 820, 822 (C. C. A. 2nd, distinguishing *Lucas* v. *Earl*, *Mitchel* v. *Bowers*, and *Harris* v. *Commissioner*, all *supra*); *Kaufman* v. *Commissioner*, 44 F. (2d) 144 (C. C. A. 3rd); *O'Malley-Keyes* v. *Collector*, 24 F. (2d) 436 (D. Conn., distinguishing *Mitchel* v. *Bowers*, *supra*); *Young* v. *Collector*, 28 F. (2d) 789 (D. N. J.); *McKee* v. *Collector*, 48 F. (2d) 838 (W. D. Okla.).

(3) In *Corliss* v. *Bowers*, 281 U. S. 376, the taxpayer had transferred property to trustees to pay the income to his wife for life with a remainder over to their children. He reserved the power to revoke or change the trust at his will. The Revenue Act provided that under such circumstances

the settlor should be taxable on the income from the trust.[4] The taxpayer's argument was that the net income from the trust had been paid to his wife; that the income never was his; that the legal title was in the trustees and the equitable title in his wife. This Court held the income from the trust taxable to the settlor, saying (p. 378):

> * * * if a man disposes of a fund in such a way that another is allowed to enjoy the income which it is in the power of the first to appropriate it does not matter whether the permission is given by assent or by failure to express dissent. The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not.

Other cases falling in this group are: *McCauley* v. *Commissioner*, 44 F. (2d) 919 (C. C. A. 5th); see also *Mitchel* v. *Bowers*, *supra*, 15 F. (2d) 287, 289 (first ground of the decision); *Cohan* v. *Commissioner*, *supra*, 39 F. (2d) 540, 542–543; *Bishop* v. *Commissioner*, *supra*, Prentice-Hall Federal Tax Service (1932) 388, 391; *Leydig* v. *Commissioner*, See *supra*, ~~p. 10.~~ 43 F. (2d) 494–496.

The cases in this group are analogous to the present case for the reason stated by the court in *Bing* v. *Bowers*, *supra*, 22 F. (2d) 450, 454:

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[4] In *McCauley* v. *Commissioner*, 44 F. (2d) 919 (C. C. A. 5th), the court said that this provision of the Revenue Act was merely declaratory of existing law.

> * * * the power over the creation of this gross income and over the expenditure therefrom that determined the net remained in the grantor, not as a trustee of the property itself, subject to the cestui que trust's right to appeal to a court of equity, but as his personal right uncontrolled. The gross income, like the principal, the property itself, was his. The right to determine the deductions therefrom was his; only when this power had been exercised, did the net fund, or he as its owner, become charged with the duty to perfect the gift by payment to the grantee, or in any case by not preventing the grantee from receiving therefrom the amount granted to her. Not until the net was ascertained could the grantee's right attach to any specific fund. Before that the grantor had received the rents as his income from the property.

The situation in the instant case was similar. See *supra*, p. 10.

II

RESPONDENT'S WIFE DID NOT BECOME A MEMBER OF THE PARTNERSHIP

The burden rested upon respondent to prove all the facts necessary to establish the illegality of the Commissioner's determination. *Phillips, Collector* v. *Dime Trust & Safe Deposit Company*, 284 U. S. —, No. 18, October Term, 1931, decided November 23, 1931; *Burnet* v. *Houston*, 283 U. S. 223, 227;

Lucas v. *Structural Steel Company*, 281 U. S. 264, 271; *United States* v. *Mitchell*, 271 U. S. 9, 12. It was therefore essential for him to show that his wife had become a member of the partnership. Point I, *supra*. If we are in error in our belief that under the statutes only partners may return partnership income, it was at least necessary for respondent to show that his wife owned a share of the income-producing *corpus* of the partnership.

The agreement between respondent and his wife did not, we submit, make her a partner in the Eagle Laundry Company. The text of the agreement does not appear, and the findings state only that the agreement "acknowledged that petitioner's [respondent's] wife had been and was a full equal partner *with him* in the interest in the Eagle Laundry Company, entitled to share equally in the profits and obligated to bear equally any losses." (R. 17.) (Italics ours.)

Moreover, the law and the facts indicate clearly that the wife was not a partner in the Company. In order to establish that she had become a partner, it was necessary to prove that the other partners had consented to such an arrangement. See *Pagel* v. *Creasy*, 6 Ohio App. 199, 207–208; *Cohan* v. *Commissioner*, *supra*, 39 F. (2d) 540, 542. There is no finding that such consent existed and all fair inferences are to the contrary. The partnership income-tax returns, sworn to by respondent (R. 18), stated that he and another each held a half

interest in the partnership. Compare *Bedell* v. *Commissioner*, 30 F. (2d) 622, 625 (C. C. A. 2nd). The name of respondent's wife did not appear on the books of the Company. Checks covering profits payable on the half interest standing in respondent's name were made out to him. (R. 17.) It does not appear that there ever was any accounting between her and the other members of the partnership. An Ohio statute (*infra* p. 32) requires partnerships doing business under titles not revealing the names of the partners to file certificates stating the names of the partners with the clerk of the court of common pleas. It does not appear that the name of respondent's wife was on any certificate filed by the Eagle Laundry Company. The contract between respondent and his wife was never filed in any place of public record. (R. 17.)

Furthermore, she did not possess other powers which ordinarily or necessarily inhere in a partner. She took no part in the management of the business. See *Coleman* v. *La Bounty Amusement Co.*, 21 Ohio App. 44, 49–50; *Cohan* v. *Commissioner*, *supra*, 39 F. (2d) 540, 542. She made no contribution to its capital (R. 17) and it does not appear that she contributed any services. See *Cohan* v. *Commissioner*, 11 B. T. A. 743, 757. It does not appear that she ever acquired or assumed to exercise any authority to act as agent for the Company. See *Service Co.* v. *Public Utilities Commission*, 115 Ohio St. 405, 413-

414; *Petition of Williams*, 297 Fed. 696, 702-704 (C. C. A. 1st), certiorari denied, *sub nom. Wolff* v. *Williams*, 265 U. S. 593.

The mere right to share in the profits of a partnership does not make one a partner, even where the right is directly against the partnership and not, as here, by virtue of an independent agreement with one of the partners. *Service Co.* v. *Public Utilities Commission*, 115 Ohio St. 405, *supra*; *Hayes* v. *State*, 14 Ohio Cir. Ct. (N. S.) 497, 505, affirmed, 83 Ohio St. 490; *Meehan* v. *Valentine*, 145 U. S. 611. The wife's agreement to bear a share of the losses does not alter the situation, since her promise in that respect ran to her husband alone and not to the firm or the other partner.[1]

If this Court should hold that taxability of the partnership income always follows the ownership of the income-producing *corpus*, the respondent still must fail. For here that *corpus* consisted of the physical and intangible assets of the Company. To the extent that these elements of a going business could be owned, they belonged to the partners of the Eagle Laundry Company as joint owners. As the Circuit Court of Appeals for the Second Circuit said in *Mitchel* v. *Bowers*, *supra*, 15 F. (2d) 287, 289, "ownership follows the status" of a partner.

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[1] For a discussion of the question when one becomes a partner see Douglas, Vicarious Liability, Part II, 38 Yale Law Journal 720.

Respondent argues in his brief in opposition to the petition for certiorari (p. 5) that by the agreement with him his wife became a legal or equitable owner in the assets of the company. But in Ohio, as elsewhere, a partner does not own a direct interest in the partnership property. He has only a right to his share of the profits and, upon dissolution, to his share, if any, of the assets of the firm remaining after payment of debts and adjustment of the rights of the partners *inter sese*. *Bank* v. *Carrollton R. R.*, 11 Wall. 624, 628–629; *Case* v. *Beauregard*, 99 U. S. 119, 124; *Nixon* v. *Nash*, 12 Ohio St. 647, 650; Parsons on Partnership (4th ed.), Sec. 178; Rowley, Modern Law of Partnership, Secs. 291, 292.

If a partner attempts to convey an interest in the assets of the firm, the partnership is dissolved forthwith. *Bank* v. *Carrollton R. R., supra*, 11 Wall. 624, 628; *Harris* v. *Commissioner, supra*, 39 F. (2d) 546–547. The assignee obtains only the right to the assignor's share, if any, of the assets of the firm remaining after liquidation. *Bank* v. *Carrollton, supra*, 11 Wall. 624, 629; cf. *Nixon* v. *Nash, supra*, 12 Ohio St. 647, 650. It certainly was not the intention of respondent, by the agreement with his wife, to dissolve the partnership. The business of the Laundry Company continued thereafter as it had before. The wife asserted no claim to ownership of any of the partnership assets. She did not demand dissolution and an accounting. It seems clear that all the agreement

did, or was intended to do, was to give the wife the right to one-half the profits paid respondent, and possibly the right to one-half of the assets, if any, distributed to him upon the dissolution of the firm. *Harris* v. *Commissioner, supra,* 39 F. (2d) 546, 547; *Harris* v. *Commissioner,* 11 B. T. A. 871, 874–875. These were very different rights from respondent's right as a partner. They were rights against respondent on the contract with him, and not, like his rights, against the partnership *in rem*. *Mitchel* v. *Bowers, supra,* 15 F. (2d) 287, 289; *Harris* v. *Commissioner,* 11 B. T. A. 871, 875. We submit that respondent has failed to show that his wife acquired any interest, legal or equitable, in the income-producing *corpus* of the Eagle Laundry Company.

CONCLUSION

The judgment of the court below was erroneous. It should therefore be reversed.

Respectfully submitted.

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APPENDIX A

FEDERAL STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1062, 1064, 1065, 1070, 1074:

> SEC. 210. That * * * there shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax * * *.
>
> SEC. 211. (a) That * * * in addition to the normal tax imposed by section 210 of this Act, there shall be levied, collected, and paid for each taxable year upon the net income of every individual, a surtax * * *.
>
> SEC. 212. (a) That in the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by section 214.
>
> SEC. 213. That for the purposes of this title * * * the term "gross income"—
>
> (a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales * * *; also from * * * gains or profits and income derived from any source whatever. * * *.
>
> SEC. 218. (a) That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share,

whether distributed or not, of the net income of the partnership for the taxable year * * *.

* * * * *

(d) The net income of the partnership shall be computed in the same manner and on the same basis as provided in section 212 * * * [exception not material here].

PARTNERSHIP RETURNS

SEC. 224. That every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

The corresponding sections of the Revenue Act of 1921, c. 136, 42 Stat. 227, 233, 237–238, 245, contain provisions identical with those of the 1918 Act above quoted, except that Sec. 218(d), *supra*, appears in the 1921 Act as Sec. 218(c).

Revenue Act of October 3, 1917, c. 63, 40 Stat. 300, 303:

SEC. 201. That * * * there shall be levied, assessed, collected, and paid for each taxable year upon the income of every * * * partnership * * * a tax * * *.

Treasury Department Regulations 45, promulgated under the Revenue Act of 1918:

ART. 321. *Partnerships.*—Partnerships as such are not subject to taxation under the statute, but are required to make returns of income. See section 224 of the statute and

articles 411 and 412. Individuals carrying on business in partnership are, however, taxable upon their distributive shares of the net income of such partnerships, whether distributed or not, and are required to include such distributive shares in their returns. The net income of a partnership shall be computed in the same manner and on the same basis as the net income of an individual * * * [exception not material here].

ART. 322. *Distributive shares of partners.*—The distributive share of the net income of a partnership which a partner is required to include in his return is his proportionate share of the net income of the partnership * * *.

ART. 54. *Examples of constructive receipt.*— * * * The distributive share of the profits of a partner in a partnership * * * is regarded as received by him, although not distributed. See section 218 of the statute and articles 321–335. * * *

Articles 53, 331, and 332 of Treasury Regulations 62, promulgated under the Revenue Act of 1921, are substantially the same as Articles 54, 321, and 322 of Regulations 45.

APPENDIX B

OHIO STATUTES

Page's Annotated Ohio General Code, Secs. 8099, 8102, 8104:

SEC. 8099. *Certain partnerships required to file certificate.*—Except as otherwise provided in the next following section, every partnership transacting business in this state under a fictitious name, or a designation not showing the names of the persons interested as partners therein, must file with the clerk of the common pleas court of the county in which its principal office or place of business is situated, a certificate to be indexed by him, stating the names in full of all the members of the partnership and their places of residence.

SEC. 8102. *New certificate on change in membership* * * *.—On every change of the members of a partnership transacting business in this state under a fictitious name or designation which does not show the names of the persons interested as partners in the business, except in the cases mentioned in section eighty-one hundred, a new certificate must be filed with the clerk of the common pleas court as required by section eighty-hundred and ninety-nine, on the formation of such partnership. * * *

SEC. 8104. *Partnership certificate.*—Any persons doing business as partners contrary to the provisions of the next five preceding sections, shall not commence or maintain an action on or on account of any contracts made, or transactions had in their partnership name in any court of this state, until they first file the certificate therein required. * * *

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